

ADVICE AND CONSENT QUESTIONS
COMMISSIONER OF OFFICE OF FINANCIAL AND INSURANCE SERVICES

1. How would you characterize the state of banking in Michigan?
2. Compared to other states, do you think that Michigan consumers receive fair value for their money for the services and products they receive from financial institutions?
3. How would you characterize the state of the insurance industry in Michigan?
4. Compared to other states, do you think that Michigan consumers receive fair value for their money for the coverage, services and products they receive from insurance institutions?
5. What role do you think government should play in the regulation of financial and insurance institutions?
6. What are your views on using credit scoring to set insurance rates?
7. What is redlining?
8. Do you believe that insurance companies in Michigan engage in the practice of redlining? If yes, explain and what would you do to address this problem?
9. Do you believe the MCCA is an effectively run organization? Please explain.
10. What is your position on the current bills in the legislature which deal with small market reform?
11. Recently, Michigan was awarded \$12.6 million as part of a national stock trading settlement. What plans do you, as OFIS Commissioner, have for using these funds to enhance investor education?

ADVICE AND CONSENT QUESTIONS

LINDA A. WATTERS, COMMISSIONER OF OFFICE OF FINANCIAL AND INSURANCE SERVICES

1. How would you characterize the state of banking in Michigan?

The overall state of banking in Michigan is good. In the face of a very challenging economy over the last three years, Michigan banks have continued to post strong earnings. Asset quality is good and most banks have continued to demonstrate acceptable asset/liability management skills. The Michigan Bank Charter continues to be the charter of choice. Over 80% of the banks located in Michigan are state chartered. Michigan banks are led by strong management teams and continue to offer Michigan residents a wide variety of products and services. The OFIS staff maintains a strong and productive relationship with the Federal Reserve and the FDIC. There are 143 state chartered banks in Michigan, 274 credit unions and one corporate credit union.

2. Compared to other states, do you think that Michigan consumers receive fair value for their money for the services and products they receive from financial institutions?

Michigan consumers are very well served by Michigan financial services providers and I believe they receive a fair value for their money. Michigan citizens benefit from having a large number of financial institutions doing business in our state. OFIS regulates over 237,000 entities and they have chosen to operate in our state both because of the great demand for financial products and services and because of a regulatory climate that encourages innovation and introduction of new products and services.

Changes in federal laws have increased the number of financial services providers, permitting banks, insurance companies and other financial services companies to compete with one another, creating a market advantage for the consumer.

Additionally, out of state financial services providers doing business in Michigan give our consumers an opportunity to evaluate and take advantage of new products.

3. How would you characterize the state of the insurance industry in Michigan?

I would characterize the state of the insurance market in Michigan as very competitive given the large number of companies doing business in the state. The relationship OFIS has with the industry and industry groups demonstrates Michigan's ability to understand the technical nuances of the insurance business and develop measures to protect the consumer. OFIS' representation in

leadership positions on national association boards and committees reflects our commitment to use the best practices in our regulatory procedures.

4. Compared to other states, do you think that Michigan consumers receive fair value for their money for the coverage, services and products they receive from insurance institutions?

The measurement of value from an insurance perspective differs from value derived from a specific product purchased from the financial institutions the consumer is using each day like the cost of a money order, travelers cheque or wire transfer. Insurance value is the perceived value and claims experience by the consumer for the coverage they receive from insurance institutions. Michigan is one of 14 states that use a no-fault system, a value and service to our citizenry. Michigan ranks 9th in the amount of premium volume collected per state and close to average for the number of companies doing business in the state.

5. What role do you think government should play in the regulation of financial and insurance institutions?

The role of government in the regulation of financial and insurance institutions is to maintain public confidence in the industries, institutions and individuals providing financial services to Michigan citizens. We must ensure institutional solvency, safety and soundness; monitor and warn of system risks that confront our financial services providers; make certain that auto and homeowners insurance products remain available and affordable; protect and empower consumers; ensure that industries, institutions and individuals comply with applicable laws and rules; and finally, work to increase market competitiveness. The Commissioner must enforce the Insurance Code, the Nonprofit Health Care Corporation Reform Act (BCBSM), the Banking Code, the Credit Union Act, the Securities Act and numerous other laws governing the activities of financial services providers.

6. What are your views on using credit scoring to set insurance rates?

In exploring this issue, the use of credit scoring to set insurance rates has raised concerns in the following areas:

- The credit reports contain errors, which adversely limit the discounts consumers can take advantage of;
- Home refinancing, given the favorable rate environment, increase the number of inquiries and produces lower scores and fewer discounts for the consumer;
- The impact of catastrophic illness on the credit score;
- Driving history vs. credit card debt;
- Demographics.

My view is that more research, information and discussions should be analyzed by OFIS before conclusions can be made regarding credit scoring as a measurement to grant discounts and set rates. In the interim we issue OFIS Bulletins for guidance and enforcement.

7. What is redlining?

Random House Webster's Unabridged Dictionary, Second Edition, 1998, defines redlining as follows: "a discriminatory practice by which banks, insurance companies, etc., refuse or limit loans, mortgages, insurance, etc., within specific geographic areas especially inner-city neighborhoods; as if banks, insurance companies, etc., had outlined such areas in red on a map."

Black's Law Dictionary, Abridged Fifth Edition, 1983, defines redlining as follows: "Redlining is a pattern of discrimination in which financial institutions refuse to make mortgage loans, regardless of credit record of the applicant, on properties in specified areas because of alleged deteriorating conditions. At one time, lenders actually outlined these areas with a red pencil. Such practice violates federal laws."

8. Do you believe that insurance companies in Michigan engage in the practice of redlining? If yes, explain and what would you do to address this problem?

Since one of the factors that insurers may legally use to determine how much policyholders should pay for insurance is the location of the driver's and/or homeowner's residence, they are making a distinction between risks. Insurers divide the state into territories and charge premiums based partly on anticipated losses and costs in each territory. There are predictable differences in costs between areas based on traffic, theft rates, medical costs, auto and home repair expenses, and other measurable factors. The question should be how does ratemaking by the insurers affect the consumer's ability to purchase affordable insurance as outlined in the Essential Insurance Act? This is a study OFIS should undertake to determine whether insurance is too expensive in some geographic areas for the consumer to purchase. If yes, and the consumer decides to go uninsured, then, does this constitute redlining because they are priced out of the market. Since the consumer is not 'refused or limited' from insurance, is it redlining? Our data show the percentage base rate increases in Michigan for the top 20 insurers over the last seven years range from a low of 37% to 117% increase for this period. Such a wide spread warrants further investigation by OFIS.

9. Do you believe the MCCA is an effectively run organization? Please explain.

The Michigan Catastrophic Claims Association (MCCA) is an effectively run organization. A surplus has been used as a credit to the MCCA assessment since

1995. Since 1995, the MCCA has returned \$3 billion in surplus, including a one-time lump sum payment of \$180 to Michigan citizen for each of their insured vehicles as of March 18, 1998. Although the MCCA fund has experienced cycles of surplus and deficit, historically, it appears that the MCCA board has managed the Association conservatively in an attempt to keep the fund balanced and at a level sufficient to pay claims. Unfortunately, an increase in medical expenses combined with a recent "bear" market has put the association into a deficit situation and the MCCA announced a 2003 assessment of \$100.20 per vehicle. Worth noting, there are funds to pay claims now and into the future since the MCCA assessment is calculated for both current and anticipated medical costs associated with catastrophic auto insurance claims.

10. What is your position on the current bills in the legislature, which deals with small market reform?

OFIS is supportive of the effort to stabilize the rates charged; the availability and affordability of health insurance; consumer protection and the prevention of adverse selection in Michigan.

OFIS is supportive of limiting the employer group size to the HIPAA required 2 to 50 with the requirement that BCBSM cover sole proprietors and the other carriers who, on a voluntary basis, cover sole proprietors being subject to the new requirements.

Have worked with both Senate and House Committees on the Bills.

We support the concept of rate bands. The question is how wide and what is included in the bands.

Our concerns for the consumer continue to be stability, affordability, accessibility, and elimination of adverse selection. The effort by the Michigan Legislature in passing these bills will help move Michigan forward in reaching our goal of stabilizing rates in this marketplace and making health insurance affordable for and available to Michigan citizens. If our concerns are addressed, OFIS will recommend to the Governor that she sign these bills into law.

11. Recently, Michigan was awarded \$12.6 million as part of a national stock trading settlement. What plans do you, as OFIS Commissioner, have for using these funds to enhance investor education?

I believe that a portion of the penalties awarded to the State of Michigan should be used to fund an Investor Protection Initiative focused on enhancing financial literacy and protecting vulnerable populations. I have recommended \$3 million in a supplemental appropriation with work project status to enable expenditures over

multiple fiscal years. An advisory committee appointed by CIS/OFIS would guide the selection of specific investor protection strategies and projects.

I envision three main components:

1. Adult Education Training Program focused on helping adults enhance their money skills. This component would partner with community groups that already have a delivery system to provide outreach curriculum to vulnerable populations. The materials could focus on teaching personal financial management skills and the basic principals of saving, investing and protection against predatory practices. Community groups like AARP, community action agencies, senior groups and the Michigan Poverty Law center are examples of organizations that could be invited to partner with OFIS on this initiative.
2. School-Based Investor Education Partnerships between OFIS and groups with statewide K through 12 programs like the Michigan Economic Education Council.
3. Anti-Fraud Initiative targeting unlicensed securities scam artists through partnerships with community agencies such as the North American Securities Administrators Association, county prosecutors, the state police, attorneys general and other criminal enforcement agencies. Activities will include multi-state actions and enforcements to information sharing procedures. The goal of this component is to protect vulnerable populations, such as senior citizens.